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Alvin E. Evans

University of Kentucky

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THE COLLUDING AND THE MISTAKEN TRUSTEE

The Harvard Law Review¹ criticizes a Kentucky decision, *Willson v. Louisville Trust Company*² and seems to regard the conclusion as one result though not a necessary result of the reasoning in *Wetmore v. Porter*.³ In the latter case it was held that a trustee who colludes with a confederate may repent and bring an action against the confederate for the restoration of the trust property. In the Kentucky case it was held that the trustee alone had the power to bring the action, and if he failed to do so the infant beneficiary was bound after the statute of limitations had run against the trustee. In *Wetmore v. Porter*⁴ it seems clear that no wrong had been done to the trustee since he had consented to the transaction but it would appear that a tort had been committed to the beneficiary and the latter should have an independent right of action against the confederate. In such case the beneficiary should be bound by his own laches only, and not by the neglect of the trustee. It seems then, that in such case, the *cestui que trust* has a choice whether he will bring an action independently or whether he will permit his interests to be vindicated through the trustee.⁵ A somewhat similar result was reached in *Francis Oil Co. v. Mansville Co.*⁶ Here a corporation, through its officers, had conspired with a broker whereby its present stockholders were fraudulently induced to buy more of its stock. On failure of the broker to account for the proceeds of sales, it was held that the corporation could maintain a bill in equity. The suit was recognized as an action for and in behalf of the stockholders, though a certain small number, namely the officers-stockholders, who had committed the wrong, would also benefit by a recovery.

Where there is negligent non-action by the trustee it is commonly said that the *cestui que trust*, though not *sui juris*, is bound when the statute of limitations has run against the

¹ 12 Harv. L. Rev. 133 (1898).

² 102 Ky. 522 (1898) 12 A. L. R. 132 (1898).

³ 92 N. Y. 76 (1883).

⁴ *Supra*, note 3.

⁵ 11 Col. L. R. 686.

⁶ 296 F. 349, 352 (1924).

trustee.⁷ The only right or power belonging to the *cestui que trust* is that of compelling the trustee to do his duty, in which action he may join the third party⁸ to avoid circuity of action.⁹ It therefore appears that there is a sharp distinction between negligent or wilful non-action and wilful or fraudulent performance.

The criticism above referred to implies a condemnation of the theory as to the power of the colluding trustee to sue because, granted once the trustee may sue, courts are likely to reach the conclusion that he only may sue, and if he does not sue the *cestui que trust* is bound by the failure of the former to bring an action within the proper time. The Kentucky court is accused of adopting this *non-sequitur*. Is this a proper criticism?

There are five situations which it may be important to distinguish: (a) the trustee negligently fails to act, as in *Wyck v. East India Company*¹⁰; (b) the trustee colludes with a confederate, as in *Wetmore v. Porter*; (c) the trustee acts negligently but without bad faith and the obligor acts without bad faith but with notice, as in *Price v. Blakemore*¹¹; (d) the trustee acts in good faith and exercises such judgment as the average man under similar circumstances would exercise and the third party acts in good faith but with notice, as in *Willson v. Louisville Trust Company*¹²; (e) the trustee acts in good faith but is overreached by the third party, as in *Elliott v. Landis Machine Company*.¹³

Presumably the author of the note above referred to¹⁴ distinguishes only between non-action on the one hand and some

⁷ *Wyck v. East India Co.*, 3 P. Wms. 309 (Ch. 1734).

⁸ The term "third party" will be used for convenience in this discussion to designate the person who deals with the trustee having notice of the trust, though it does not accurately describe him. The term "confederate" is used where there is collusion.

⁹ *Fogg v. Middleton*, 2 Hill Ch. 591 (S. C. 1837).

¹⁰ *Supra*, note 7.

¹¹ 6 Beav. 507 (Ch. 1843). Here trustee joined life tenant in conveying the trust property and negligently permitted him to buy other property with the proceeds and take legal title in fee in his own name. It was held that the trustee was the one to sue to enforce the trust rather than the remaindermen-beneficiaries.

¹² *Supra*, note 2.

¹³ 236 Mo. 546, 139 S. W. 356 (1911); 11 Col. L. Rev. 686 (1911).

¹⁴ *Supra*, note 1.

mistaken or collusive action by the trustee on the other hand. In the former case the *cestui que trust* has no independent cause of action against the third party, but in the latter case he should always have one, no matter what the circumstances. The good or bad faith of the trustee or of the third party is regarded as without significance. But is that a sound and proper conclusion?

It might be assumed that a colluding trustee was in *pari delicto* and therefore precluded from bringing an action.¹⁵ No case has been found where recovery was refused expressly on that ground. In fact, none of the exceptions noted by Professor Woodward fit him.¹⁶ When therefore, he is allowed to recover, it must be not because of his own merit, but because this method is convenient for the beneficiary. It is generally held that a debtor who transfers his property to a transferee with notice in fraud of his creditors, may not himself sue and recover. He is in *pari delicto* with his grantee.¹⁷ There is the exception where he conveys to his attorney on the latter's advice.¹⁸ A very similar thing occurs where the trustee and the *cestui que trust* conspire together to convey trust property to another person to protect the estate. Thus in *Place v. Hayward*,¹⁹ the executor-trustee, with the connivance of the beneficiary, transferred the estate to protect the settlor's husband, the beneficiary, from the claims of his creditors. The court found that there was no intent to defraud the creditors of the estate, and no actual intent to defraud anyone, and allowed the trustee to recover the property.

Of course if a colluding trustee may sue, a trustee who acts mistakenly but in good faith should be able to sue. If the mistaken trustee, acting in good faith, or the colluding trustee, may sue, his co-trustee should be able to sue the third party,²⁰ and if such trustee is removed his successor should be

¹⁵ See Woodward on Quasi-Contracts sec. 135 (1912).

¹⁶ Op. cit. sec. 136-146.

¹⁷ *Atwood v. Lester*, 20 R. I. 660, 40 A. 866 (1898); 12 Harv. L. Rev. 359 (1898).

¹⁸ *Goodenough v. Spencer*, 15 Abb. Pr. N. S. 248 (N. Y. 1874); *Place v. Hayward*, 117 N. Y. 495, 23 N. E. 25 (1889).

¹⁹ *Supra*, note 18.

²⁰ *Bayard v. Wooley*, 20 Beav. 385 (Ch. 1855); *Franco v. Franco*, 3 Ves. Jr. 75 (Ch. 1796); *Clemens v. Heckscher*, 185 Pa. 476, 40 A. 80 (1898).

able to sue.²¹ All this has nothing to do with the question whether laches or the statute of limitations will prevent the beneficiary from suing the trustee. Presumably after there is a repudiation of the trust by the trustee of which the beneficiary has notice, the statute of limitations or laches binds the latter.²²

But some courts deny a trustee who has mistakenly acted, any power to sue at all. He is not denied the power to sue on the ground of being in *pari delicto* because the very assumption here is that there is no *delictum*. Surely if he has acted mistakenly but with good faith and without negligence, he is not liable to the beneficiary. He does not always act at his peril. He is estopped from suing, say these courts, because he cannot deny his own conveyance. *Parker v. Hall*²³ is commonly assumed to deny only the power of the colluding trustee to sue, and so is assumed to be sound, because under these circumstances a right of action is acknowledged to exist in the *cestui que trust*. But while the situation before the court was parallel to that in *Wetmore v. Porter*, in fact the court goes much further than simply to deny to the colluding trustee a power to sue. It denies every trustee who has mistakenly acted a power to sue, and affirms that the *cestui que trust* only can sue, and therefore there can be no issue whether the statute of limitations which otherwise would have run against the trustee, affects an infant beneficiary. "That doctrine" (that when the trustee is barred the beneficiary is barred) "only applies where the trustee could sue but fails to do so, as where a stranger intrudes himself into the trust estate and holds wrongfully and adversely both to the trustee and to the beneficiaries."²⁴ That is, the *cestui que trust* is bound only by negligent non-action of the trustee, and not by his acts, however much he may have acted in good faith, but the latter is bound by his own acts and cannot repudiate them. There are several other jurisdictions which have denied the trustee a power to sue after he has mistakenly acted.²⁵

²¹ *Safe Deposit & Trust Co. v. Cahn*, 102 Md. 530, 62 A. 819 (1906); *Leake v. Watson*, 58 Conn. 332, 20 A. 313 (1890).

²² *Rosson v. Anderson*, 9 B. Mon. 423 (48 Ky. 1849).

²³ 2 Head 641 (Tenn. 1859).

²⁴ *Supra*, note 23.

²⁵ *Chase v. Cartwright*, 53 Ark. 358 (1890); *Herron v. Marshall*, 5 Humph 443 (Tenn. 1844); *Elliott v. Landis Machine Co.*, *supra*, note 13; *Coker v. Hughes*, 205 Ala. 369, 37 So. 321 (1920).

It is more generally held however, that where a trustee mistakenly acts in good faith and makes an improper disposition of trust property, he and he only may still recover the same.²⁶ If this be a sound result (and it is supported by the Supreme Court of the United States),²⁷ then the *cestui que trust* is bound by failure of the trustee to sue the third party. If the trustee cannot sue at all, then of course no question arises about the *cestui que trust* being bound. All cases which note the problem at all have held that if the mistaken trustee acting in good faith may sue, the *cestui que trust* is bound by his failure to do so.²⁸

It has been argued that the difference between negligent non-feasance by the trustee and good faith but mistaken feasance is that in the former case the *cestui que trust* has only a right to compel the trustee to perform, but in the latter case he has acquired rights independent of those of the trustee against the third party taking trust property with notice; that in the former case the beneficiary is bound by the non-action of the trustee when the statute of limitations has run, but in the latter case he is not so bound.²⁹ But this distinction seems shadowy unless in the latter case the third party dealt fraudulently and collusively with the trustee. The failure to undo his own deed is also negligent non-action. If a fraud has been committed upon the trustee³⁰ it is of course the same act which injures the beneficiary. But surely the trustee should be able to recover for the wrong, and there is the same policy involved as there is in *Wych v. East India Company* to hold that the *cestui que trust* should be bound.

In Missouri there is a curious distinction made. In *Ewing v. Shannahan*³¹ where the trustee in good faith reconveyed premises to the settlor S, to assist the latter in revoking the

²⁶ *Meeks v. Olpherts*, 100 U. S. 566 (1880); *Smilie v. Biffle*, 2 Pa. St. 52 (1845); *Wingfield v. Virgin*, 51 Ga. 139 (1874); *Molton v. Henderson*, 62 Ala. 426 (1878); *Lee v. Horton*, 104 N. Y. 540, 11 N. E. 50 (1887); *Place v. Hayward*, *supra*, note 18; *Abbott v. Reeves*, 49 Pa. St. 494 (1865); *Greenwood v. Wakeford*, 1 Beav. 576 (Ch. 1839).

²⁷ *Meeks v. Olpherts*, *supra*, note 26.

²⁸ See cases cited in note 26, *supra*, and cf. 11 Col. L. Rev. 686 (1911).

²⁹ 11 Col. L. Rev. 686 (1911).

³⁰ *Elliott v. Landis Machine Co.*, *supra*, note 13.

³¹ 113 Mo. 196, 20 S. W. 1065 (1892).

trust, it was held that the beneficiaries were bound by the adverse possession of S. But in *Elliott v. Landis Machine Company*³² it was held that the *cestui que trust* was not so bound. In this latter case the trustee was imposed upon by intermediaries and did not deal directly with the purchaser, though the latter had notice of the trust. In the former case it was held that since the trustee had held the legal title he had the sole right of action. But that result was denied in the latter case. The court seeks to bring this within some rule like that in *Parker v. Hall*³³ that a guilty trustee cannot sue; hence, the *cestui que trust* is not bound by the statute of limitations. It declares the difference between the two cases to be that in the first case the trustee dealt directly with the purchaser, whereas in the second he dealt through intermediaries. This seems to be a distinction without a difference, and conflicts with *Wetmore v. Porter* as to the right of action in the trustee. In *Wetmore v. Porter* the court however, makes no observation as to whether, if the trustee should not sue, the statute would run as against the *cestui que trust*. There is, however, this distinction—that the trustee in the latter Missouri case was overreached, which was not true in the former. This wrong, however, seems to be one directed against the trustee rather than against the *cestui que trust*, and for such wrong surely the trustee should have a right of action. As there is no real distinction between the two cases, Missouri must now be regarded as adopting the rule of *Parker v. Hall* in Tennessee that both the mistaken and the colluding trustee are estopped from bringing an action.

If the trustee can bind the *cestui que trust* by negligent non-action, why should not his mistaken action bind the *cestui que trust*? There is the same policy of repose involved. Where the trustee has negligently acted, the beneficiary has a cause of action against him rather than against the third party. Unless the third party has colluded he has done no wrong to the *cestui que trust* and the latter should not have an independent action. It is conceived that a wrongful act not collusive, is a wrong to the trustee and not to the *cestui que trust*. If the

³² *Supra*, note 13.

³³ *Supra*, note 23.

trustee refuses to proceed to right the wrong, then as in other cases, the *cestui que trust* should be able to sue the trustee and join the third party in one suit. It is believed that in such case the right of action to repudiate the transaction should be in the trustee, and the *cestui que trust* should be bound by the failure of the former to repudiate it. Therefore *Willson v. Louisville Trust Co.*³⁴ seems sound. There is nothing to show that if the Kentucky Court were faced with the problem which arose in *Wetmore v. Porter* it would not follow the same course and permit the *cestui que trust* a choice of two methods of procedure.

We may draw the following conclusions:

(1) A trustee is not subject to the rule applied to persons in *pari delicto*. (2) Some courts deny him a right of action where he has acted mistakenly because he cannot question his own conveyance, whether made in good or bad faith. But just as the better view permits the personal representative to sue a grantee who had received a debtor's property in the life time of the debtor in fraud of his creditors³⁵ because he represents claimants against the estate as well as the deceased, so does the mistaken trustee represent the *cestui que trust* as well as himself, and he should be permitted to sue. If however, the trustee cannot sue, the *cestui que trust* should be able to sue and his right should not be affected save by his own laches. (3) Where there is collusion some courts allow the right of the *cestui que trust* to be asserted either by himself or by the colluding trustee. Presumably when the right is so asserted by either, the other cannot thereafter sue. Certainly if the *cestui que trust* permits the trustee to sue, his right of action in equity should be foreclosed. (4) It is difficult to find an essential difference between negligent nonaction by the trustee, and good faith but mistaken dealing by him with a third party who also deals in good faith.

If *Wyck v. East India Co.* continues to represent the law, then *Willson v. Louisville Trust Co.* should also reach a sound result. This accords with the orthodox theory that the *cestui que trust's* sole right is against the trustee, and that he does

³⁴ *Supra*, note 2.

³⁵ *Buehler v. Gloninger*, 2 Watts 226 (Pa. 1834).

not have an *in rem* interest in the property. Recent cases however, which have permitted the *cestui que trust* to sue the obligor directly when it was not feasible to join the negligent trustee, raise a serious issue whether in all cases the *cestui que trust* has not a larger interest than a mere right to hold a trustee to his duty. But they do not as yet go the length of overruling the principle involved in *Wyck v. The East India Co.*

ALVIN E. EVANS